



An **ATCO** Company

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

**FOR THE THREE MONTHS ENDED
MARCH 31, 2005**

CU INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ("MD&A")

The following discussion and analysis of financial condition and results of operations of CU Inc. (the "Corporation") should be read in conjunction with the Corporation's unaudited interim financial statements for the three months ended March 31, 2005, and the audited financial statements and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2004 ("2004 MD&A"). Information contained in the 2004 MD&A that is not discussed in this document remains substantially unchanged. Additional information relating to the Corporation, including the Corporation's Annual Information Form, is available on SEDAR at www.sedar.com.

The common share capital of the Corporation consists of Class A non-voting shares ("Class A shares") and Class B common shares ("Class B shares").

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FORWARD-LOOKING INFORMATION

Certain statements contained in this MD&A constitute forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "anticipate", "plan", "estimate", "expect", "may", "will", "intend", "should", and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Corporation believes that the expectations reflected in the forward-looking statements are reasonable, but no assurance can be given that these expectations will prove to be correct and such forward-looking statements should not be unduly relied upon.

In particular, this MD&A contains forward-looking statements pertaining to purchase obligations, planned capital expenditures, and the impact of changes in government regulation. The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of regulatory decisions, competitive factors in the industries in which the Corporation operates, prevailing economic conditions, and other factors, many of which are beyond the control of the Corporation.

BUSINESS OF THE CORPORATION

The Corporation's financial statements are consolidated from two segments: utilities and power generation (refer to Note 4 of the unaudited interim financial statements for the three months ended March 31, 2005). Transactions between segments are eliminated in all reporting of the Corporation's consolidated financial information.

TRANSFER OF THE RETAIL ENERGY SUPPLY BUSINESSES

On May 4, 2004, ATCO Gas and ATCO Electric transferred their retail energy supply businesses to Direct Energy Marketing Limited and one of its affiliates (collectively "DEML"), a subsidiary of Centrica plc ("Transfer of the Retail Energy Supply Businesses"). Proceeds of the transfer were \$90 million, of which \$45 million was paid at closing, with the remainder to be paid on May 4, 2005. Net proceeds, after adjustments related to legal, transition and other deferred costs pertaining to the transfer of the retail energy supply businesses, resulted in a gain of \$63.3 million before income taxes of \$8.2 million and increased earnings by \$55.1 million for the three months ended June 30, 2004, and for the year ended December 31, 2004.

The Corporation's revenues and natural gas supply and purchased power costs after May 4, 2004, were reduced accordingly for 2004 and thereafter. Subsequent to May 4, 2004, ATCO Gas continued to purchase natural gas on behalf of DEML until the transfer of the relevant ATCO Gas natural gas purchase contracts to DEML was completed in September 2004. There will be no ongoing impact on earnings resulting from the transfer of these businesses as natural gas and electricity have historically been sold to customers on a "no-margin" basis. ATCO Gas and ATCO Electric continue to own and operate the natural gas and electricity distribution systems used to deliver energy.

SELECTED QUARTERLY INFORMATION

(\$ Millions except per share data)	For the Three Months Ended			
	Mar. 31	Jun. 30	Sep. 30	Dec. 31
		<i>(unaudited)</i>		
2005				
Revenues (1)	505.7	.....	.....	.....
Earnings attributable to Class A and Class B shares (4) (5).....	58.3	.....	.....	.....
2004				
Revenues (1)	960.0	480.7	266.3	371.7
Earnings attributable to Class A and Class B shares (2) (4) (5)....	63.8	80.3	24.0	53.5
2003				
Revenues.....	.....	588.7	430.2	728.1
Earnings attributable to Class A and Class B shares (3) (4) (5)....	.....	32.5	25.2	54.4

Notes:

- (1) Includes the reduction in revenues from the Transfer of the Retail Energy Supply Businesses for the three months ended March 31, 2005, June 30, 2004, September 30, 2004 and December 31, 2004.
- (2) Includes the impact of the Transfer of the Retail Energy Supply Businesses for the three months ended June 30, 2004.
- (3) 2003 earnings attributable to Class A and Class B shares have been restated for retroactive changes in the methods of accounting for asset retirement obligations.
- (4) There were no discontinued operations or extraordinary items during these periods.
- (5) Due to the seasonal nature of the Corporation's operations and the timing of rate decisions, earnings for any quarter are not necessarily indicative of operations on an annual basis.
- (6) As all Class A and Class B shares of the Corporation are owned by Canadian Utilities Limited, the disclosure of earnings per share is not provided as it is not considered to be meaningful.
- (7) The above data has been prepared in accordance with Canadian generally accepted accounting principles and the reporting currency is the Canadian dollar.

RESULTS OF OPERATIONS

The principal factors that have caused variations in **revenues** and **earnings** over the eight most recently completed quarters disclosed in the 2004 MD&A remain substantially unchanged.

Consolidated Operations

Revenues for the three months ended March 31, 2005, decreased by \$454.3 million to \$505.7 million, primarily due to:

- lower sales of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses in May 2004;
- lower natural gas volumes purchased for ATCO Pipelines’ customers as a result of customers moving from sales service (commodity and transportation revenues) to transportation service only contracts (transportation revenue);
- lower cost of service revenues in Alberta Power (2000) from the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004; and
- warmer temperatures in ATCO Gas, which were 4.4% warmer than normal, compared to 1.0% warmer than normal for the corresponding period in 2004.

This decrease was partially offset by:

- customer additions in ATCO Gas.

Earnings attributable to Class A and Class B shares for the three months ended March 31, 2005, decreased by \$5.5 million to \$58.3 million, primarily due to:

- higher costs in ATCO Gas and ATCO Electric that are not reflected in current customer rates. ATCO Gas and ATCO Electric expect to file applications in the second quarter that will request the Alberta Energy and Utilities Board (“AEUB”) to incorporate these higher costs in customer rates. At the same time, ATCO Gas and ATCO Electric intend to seek relief through the establishment of interim refundable rates designed to recover these costs pending a final AEUB decision; and
- warmer temperatures in ATCO Gas.

This decrease was partially offset by:

- lower transmission costs in ATCO Pipelines; and
- customer additions in ATCO Gas.

Operating expenses (consisting of natural gas supply, purchased power, operation and maintenance, selling and administrative and franchise fee costs) for the three months ended March 31, 2005, decreased by \$449.2 million to \$309.2 million, primarily due to:

- lower costs of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses in May 2004; and
- lower natural gas volumes purchased for ATCO Pipelines’ customers as a result of customers moving from sales service (commodity and transportation costs) to transportation service only contracts (transportation costs).

This decrease was partially offset by:

- higher franchise fees in ATCO Gas.

Depreciation and amortization expenses for the three months ended March 31, 2005, increased by \$3.6 million to \$63.0 million, primarily due to:

- capital additions in 2005 and 2004.

Interest expense for the three months ended March 31, 2005, increased by \$1.6 million to \$38.5 million, primarily due to:

- interest on new financings issued in 2004 to fund capital expenditures in Utilities operations.

Interest and other income for the three months ended March 31, 2005, increased by \$0.8 million to \$2.4 million, primarily due to:

- interest income on higher cash balances.

Income taxes for the three months ended March 31, 2005, decreased by \$4.0 million to \$35.6 million, primarily due to:

- lower earnings.

Segmented Information

Segmented revenues and earnings attributable to Class A and Class B shares for the three months ended March 31, 2005, were as follows:

(\$ Millions)	For the Three Months Ended March 31			
	Revenues		Earnings	
	2005	2004	2005	2004
				(unaudited)
Utilities (1).....	431.9	884.1	44.4	49.9
Power Generation	73.9	76.9	13.9	13.6
Corporate and Other	-	-	-	0.3
Intersegment eliminations	(0.1)	(1.0)	-	-
Total.....	505.7	960.0	58.3	63.8

Note:

(1) Includes the reduction in revenues from the Transfer of the Retail Energy Supply Businesses for the three months ended March 31, 2005.

Utilities

Revenues from the Utilities Business Group for the three months ended March 31, 2005, decreased by \$452.2 million to \$431.9 million, primarily due to:

- lower sales of electricity and natural gas purchased for customers on a “no-margin” basis by ATCO Electric and ATCO Gas due to the Transfer of the Retail Energy Supply Businesses in May 2004;
- lower natural gas volumes purchased for ATCO Pipelines’ customers as a result of customers moving from sales service (commodity and transportation revenues) to transportation service only contracts (transportation revenue); and
- warmer temperatures in ATCO Gas, which were 4.4% warmer than normal, compared to 1.0% warmer than normal for the corresponding period in 2004.

This decrease was partially offset by:

- customer additions in ATCO Gas.

Earnings for the three months ended March 31, 2005, decreased by \$5.5 million to \$44.4 million, primarily due to:

- higher costs in ATCO Gas and ATCO Electric that are not reflected in current customer rates. ATCO Gas and ATCO Electric expect to file applications in the second quarter that will request the AEUB to incorporate these higher costs in customer rates. At the same time, ATCO Gas and ATCO Electric intend to seek relief through the establishment of interim refundable rates designed to recover these costs pending a final AEUB decision; and
- warmer temperatures in ATCO Gas.

This decrease was partially offset by:

- lower transmission costs in ATCO Pipelines; and
- customer additions in ATCO Gas.

Power Generation

Revenues from the Power Generation Business Group for the three months ended March 31, 2005, decreased by \$3.0 million to \$73.9 million, primarily as a result of:

- lower cost of service revenues in Alberta Power (2000) for the H.R. Milner generating plant which was sold by the Alberta Balancing Pool on January 29, 2004.

Earnings for the three months ended March 31, 2005, increased by \$0.3 million to \$13.9 million, essentially unchanged.

During the three months ended March 31, 2005, Alberta Power (2000)'s **deferred availability incentive** account increased by \$6.0 million to \$52.1 million. The increase was primarily due to additional availability incentive payments received for improved plant availability. During the three months ended March 31, 2005, the amortization of deferred availability incentives, recorded in revenues, increased by \$0.1 million to \$2.0 million.

REGULATORY MATTERS

Regulated operations are conducted by ATCO Electric and its subsidiaries, Northland Utilities (NWT), Northland Utilities (Yellowknife) and Yukon Electrical, the ATCO Gas and ATCO Pipelines divisions of ATCO Gas and Pipelines Ltd. and the generating plants of Alberta Power (2000), all of which are wholly owned subsidiaries of the Corporation.

In July 2004, the AEUB issued its generic cost of capital decision. The decision established a standardized approach for each utility company regulated by the AEUB for determining the rate of return on common equity based upon a return of 9.60% on common equity. This rate of return will be adjusted annually by 75% of the change in long term Canada bond yield as forecast in the November Consensus Forecast, adjusted for the average difference between the 10 year and 30 year Canada bond yields for the month of October as reported in the National Post. This adjustment mechanism is the same as the National Energy Board uses in determining its formula based rate of return. The AEUB will undertake a review of this mechanism for the year 2009 or if the rate of return resulting from the formula is less than 7.6% or greater than 11.6%. The AEUB also noted that any party, at any time, could petition for a review of the adjustment formula if that party can demonstrate a material change in facts or circumstances.

The decision also established the appropriate capital structure for each utility regulated by the AEUB. The AEUB determined that any proposed changes to the approved capital structure which result from a material change in the investment risk of a utility will be addressed at utility specific rate applications.

In November 2004, the AEUB announced a generic return on common equity of 9.50% for 2005. The AEUB also announced that the 2005 generic return on equity would only apply to utilities which file rate applications in 2005. If no rate applications are filed, then existing return on common equity rates will continue to apply.

ATCO Electric

ATCO Electric expects to file a General Tariff Application for the 2005 and 2006 test years in the second quarter of 2005. ATCO Electric also expects to request that the 2005 rates be implemented on an interim refundable basis pending the AEUB's decision on the general tariff application. A decision from the AEUB on the general tariff application is not expected until late in 2005 or early in 2006.

ATCO Gas

ATCO Gas expects to file a General Rate Application for the 2005, 2006 and 2007 test years in the second quarter of 2005. ATCO Gas also expects to request that the 2005 rates be implemented on an interim refundable basis pending the AEUB's decision on the general rate application. A decision from the AEUB on the general rate application is not expected until late in 2005 or early in 2006.

In October 2001, the AEUB approved the sale by ATCO Gas of certain properties in the City of Calgary, known as the Calgary Stores Block, for \$6.6 million (excluding costs of disposition) and allocated \$4.1 million of the proceeds

to customers and \$1.8 million to ATCO Gas. In January 2004, the Alberta Court of Appeal overturned this decision and directed the AEUB to allocate \$5.4 million of the proceeds to ATCO Gas. The City of Calgary has appealed this decision to the Supreme Court of Canada, which has also granted ATCO Gas leave to cross-appeal the decision. A hearing has been scheduled for May 11, 2005. Accordingly, ATCO Gas has not yet recorded the impact of the Alberta Court of Appeal decision.

In March 2004, the AEUB directed ATCO Gas to continue to reserve for the benefit of utility customers 16.7 petajoules of storage capacity at its Carbon storage facility for the 2004/2005 storage year, which ended on March 31, 2005, and allowed ATCO Midstream to continue to utilize the remaining uncontracted capacity at a rate of \$0.45 per gigajoule, up from \$0.41 per gigajoule. ATCO Gas has been granted leave to appeal this AEUB decision to the Alberta Court of Appeal. A hearing has been scheduled for June 17, 2005.

In July 2004, the AEUB initiated a written process to consider its role in regulating the operations of the Carbon storage facility.

ATCO Gas has determined that the Carbon storage operation is no longer required. Accordingly, in March 2005, ATCO Gas filed a letter with the AEUB in which it withdrew all evidence previously filed by it with respect to the 2005/2006 Carbon Storage Plan, thus providing notice that none of the related costs and revenues will form part of regulated operations on or after April 1, 2005. On March 23, 2005, the AEUB issued an interim order directing ATCO Gas to maintain the Carbon storage facility in rate base and authorizing a lease of the entire storage capacity to ATCO Midstream at a placeholder rate of \$0.45 per gigajoule until otherwise determined by the AEUB.

ATCO Gas has filed an application with the AEUB to address, among other things, corrections required to historical transportation imbalances that have impacted ATCO Gas' deferred gas account. The application requests a recovery of approximately \$11.3 million from ATCO Gas' south customers, and a refund of approximately \$2.0 million to ATCO Gas' north customers. A decision from the AEUB is expected in the second quarter of 2005.

LIQUIDITY AND CAPITAL RESOURCES

Cash flow from operations provides a substantial portion of the Corporation's cash requirements. Additional cash requirements are met externally through bank borrowings and the issuance of long term debt and preferred shares. Commercial paper borrowings and short term bank loans are used to provide flexibility in the timing and amounts of long term financing.

Cash flow from operations for the three months ended March 31, 2005, decreased by \$5.7 million to \$128.7 million, primarily due to:

- decreased earnings; and
- decreased availability incentives in Alberta Power (2000), primarily due to availability incentive payments received for improved plant availability.

Investing for the three months ended March 31, 2005, increased by \$9.1 million to \$106.6 million, primarily due to:

- changes in non-cash working capital in respect of investing activities; and
- reduced contributions by utility customers for extensions to plant.

This increase was partially offset by:

- lower capital expenditures.

Capital expenditures for the three months ended March 31, 2005, decreased by \$12.8 million to \$84.7 million, primarily due to:

- lower investment in regulated electric transmission projects.

This decrease was partially offset by:

- increased investment in regulated natural gas transportation and distribution projects.

Contractual obligations disclosed in the 2004 MD&A remain substantially unchanged as at March 31, 2005.

At March 31, 2005, the Corporation had the following credit lines that enable it to obtain funding for general corporate purposes.

	Total	Used	Available
		(\$ Millions)	
Short term committed.....	300.0	-	300.0
Uncommitted	29.1	0.2	28.9
Total.....	329.1	0.2	328.9

The amount and timing of future financings will depend on market conditions and the specific needs of the Corporation.

Future income tax liabilities of \$64.8 million at March 31, 2005, are attributable to differences between the financial statement carrying amounts of assets and liabilities and their tax bases. These differences result primarily from recognizing revenue and expenses in different years for financial and tax reporting purposes. Future income taxes will become payable when such differences are reversed through the settlement of liabilities and realization of assets.

OUTSTANDING SHARE DATA

At April 20, 2005, the Corporation had outstanding 134 Class A shares and 76 Class B shares, all of which are owned by Canadian Utilities Limited.

BUSINESS RISKS

On February 16, 2005, the Kyoto Protocol came into effect. The Corporation is unable to determine what impact the protocol may have on its operations as the Government of Canada has not yet provided industry specific details for its 2005 Climate Change Plan. It is anticipated that the Corporation's power purchase arrangements ("PPA's") relating to its coal-fired generating plants will allow the Corporation to recover any increased costs associated with the implementation of the protocol.

A number of U.S. insurance companies are the subject of lawsuits and investigations into their business and accounting practices by the Attorney General of the State of New York and the U.S. Securities and Exchange Commission. Certain of these insurers provide a portion of the Corporation's insurance coverage. The Corporation is unable at this time to determine what impact, if any, these investigations may have on the ability of the insurers mentioned to pay any corporate insurance claims which may arise.

ATCO Electric, ATCO Gas and ATCO Pipelines are regulated primarily by the AEUB, which administers acts and regulations covering such matters as rates, financing, accounting, construction, operation and service area. The AEUB may approve interim rates, subject to final determination. These subsidiaries are subject to the normal risks faced by companies that are regulated. These risks include the approval by the AEUB of customer rates that permit a reasonable opportunity to recover on a timely basis the estimated costs of providing service, including a fair return on rate base. The Corporation's ability to recover the actual costs of providing service and to earn the approved rates of return depends on achieving the forecasts established in the rate-setting process.

Transfer of the Retail Energy Supply Businesses

Although ATCO Gas and ATCO Electric have transferred to DEML certain retail functions, including the supply of natural gas and electricity to customers and billing and customer care functions, the legal obligations of ATCO Gas and ATCO Electric remain if DEML fails to perform. In certain events (including where DEML fails to supply natural gas and/or electricity and ATCO Gas and/or ATCO Electric are ordered by the AEUB to do so), the functions will revert to ATCO Gas and/or ATCO Electric with no refund of the transfer proceeds to DEML by ATCO Gas and/or ATCO Electric.

Centrica plc, DEML's parent, has provided a \$300 million guarantee, supported by a \$235 million letter of credit in respect of DEML's obligations to ATCO Gas, ATCO Electric and ATCO I-Tek Business Services in respect of the ongoing relationships contemplated under the transaction agreements. However, there can be no assurance that the coverage under these agreements will be adequate to cover all of the costs that could arise in the event of a reversion of such functions.

Canadian Utilities Limited has provided a guarantee of ATCO Gas', ATCO Electric's and ATCO I-Tek Business Services' payment and indemnity obligations in respect of the ongoing relationships to DEML contemplated under the transaction agreements.

As a result of the agreements with DEML, ATCO Gas and ATCO Electric are no longer involved in arranging for the supply and sale of natural gas and electricity to customers, but will continue to own the assets and provide the transportation and distribution services under AEUB approved rates that provide for a recovery of costs of service and a fair return

Late Payment Penalties on Utility Bills

As a result of recent decisions of the Supreme Court of Canada in *Garland vs. Consumers' Gas Co.*, the imposition of late payment penalties on utility bills has been called into question. The Corporation is unable to determine at this time the impact, if any, that these decisions will have on the Corporation.

Alberta Power (2000)

As a result of unprecedented drought conditions, the water levels in the cooling pond used by the Battle River generating plant in its production of electricity had fallen to all-time lows in early 2003 and in 2004 and the Corporation was forced to curtail production of electricity. Water levels in the cooling pond have returned to normal for this time of year and there has been no curtailment of production to date in 2005.

CHANGES IN ACCOUNTING POLICIES

Effective January 1, 2005, the Corporation prospectively adopted the Canadian Institute of Chartered Accountants guideline pertaining to the consolidation of variable interest entities. The guideline requires the Corporation to identify variable interest entities in which it has an interest, determine whether it is the primary beneficiary of such entities, and, if so, to consolidate them. This change in accounting had no effect on the consolidated financial statements for the three months ended March 31, 2005.

April 20, 2005